SBI's earnings growth may taper in near term

Most analysts still have 'buy' rating on stock even after lowering estimates

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State Bank of India's (SBI's) earnings growth may turn lacklustre in the near term, warn analysts. They say that this could be due to margin compression and likely lower fee income over the next year.

"While the cost of deposits is repricing sharply across the system, there will be relatively lower yield expansion going ahead as most of the back-book has been repriced and there is high competitive pressure on yields. We believe it will be difficult for SBI to prevent net interest margin (NIM) compression," said analysts at HSBC while downgrading the stock to 'hold' from 'buy'.

They further noted that in an environment where NIM and operating costs are under pressure, fee income becomes an important lever. "However, SBI's fee/assets remain low at 48 basis points or bps (annualised) in the quarter. Given that credit costs will likely normalise, we believe earnings growth will likely remain lacklustre for SBI over financial years 24-25," they added.

The lender's earnings for the April-June quarter of the 2023-24 financial year (Q1FY24) were mixed, with its net interest income (NII) declining 4 per cent quarter-on-quarter (Q-o-Q), led by a sharp 27 bps Q-o-Q decline in NIM to 3.33 per cent.

Net profit was up 178 per cent year-on-year (Y-o-Y) at ₹16,880 crore. The bank reported treasury gains of ₹3,850 crore, while core fees grew 4 per cent Y-o-Y to ₹6,600 crore. Slippages increased to around ₹7,900 crore in a seasonally weak quarter, though the gross non-performing asset (GNPA) and net NPA ratios stood stable. The restructured book declined to ₹22,700 crore (0.7 per cent of advances), while the special mention account (SMA) 1/2 portfolio increased to ₹7,220 crore (22 bps of loans). At the bourses, shares of India's most profitable company have declined 3 per cent over the past three days as against a 0.8 per cent rise in the benchmark BSE Sensex.

Analysts at Nomura termed SBI's sharp NIM decline "disappointing" as the lender's Y-o-Y NIM expansion of 31 bps significantly trailed private banks.

"SBI's core fee performance continues to be soft, and coupled with softer NIMs, is resulting in a drag on operating profitability. We think levers to improve core pre-provision operating profit (PPoP) may be limited going ahead," they added.

The brokerage has cut its core PPoP estimates for FY24-26 by 5 per cent to 5.5 per cent, while net profit estimate has been increased by 0.3 per cent for FY24 but cut by 2.2 per cent/2.3 per cent for FY25/FY26. It has also slashed NII estimates by around 3 per cent, each, for FY24-26. "Any incremental rerating for SBI (from current 1x forward P/B for core banking business) will require outperformance on core PPoP, which will be challenging," Nomura said.

Loan growth snarls

The bank's domestic gross advances grew 1.6 per cent Q-o-Q and 15.1 per cent Y-o-Y. However, overseas gross advances witnessed a 1.9 per cent Q-o-Q decline, and Y-o-Y growth moderated sharply to 7.4 per cent Y-o-Y (versus 19-20 per cent run-rate). Thus, overall gross advances growth was contained at 1.1 per cent Q-o-Q and 13.9 per cent Y-o-Y.

SBI's loan growth has moderated from 20 per cent in Q2FY23 to 14 per cent, reflecting a slower rise in large corporate and international segments. "While the management targets a 15 per cent loan growth in FY24, we are factoring a 13 per cent compound annual growth rate in loans over FY23-25 as sustained corporate growth is imperative to achieve 15 per cent overall growth. Further, we are factoring a 5 bps decline in overall FY24 NIM to 2.94 per cent," said Prabhudas Lilladher.

HSBC has also cut NIM estimates to average 3.21 per cent (from 3.33 per cent) over FY24-26. "We also marginally reduce our FY24 credit costs estimates to 45 bps from 50 bps earlier, resulting in 6.8 per cent/4.1 per cent/2.6 per cent cuts in our EPS estimates for FY24/25/26, respectively," it said.

NOT A HEALTHY PICTURE

PARTICULARS	REVISED ESTIMATES		% CHANGE	
	FY24	FY25	FY24	FY25
Loan growth	14%	13%	0bps	0bps
NIMs	2.90%	2.80%	-21bps	-9bps
NII (₹ cr)	151,400	167,300	-6.40%	-2.50%
PPoP (₹ cr)	89,200	101,200	-7.20%	-3.10%
Net profit (₹ cr)	53,600	56,600	-6.80%	-4.10%

Source: HSBC

GROWTH AHEAD

Brokerage	Recommendation	New TP (₹)	Old TP (₹)
HSBC	Hold	630	690
Nomura	Buy	665	680
Nuvama	Buy	705	705
MOFSL	Buy	700	700
Phillip Capital	Buy	670	730
Prabhudas Lilladher	Buy	770	770

NIM: Net interest margin; NII: Net interest income; PPoP: Pre-provision operating profit; Bps: basis points; TP: Target price
Source: Brokerage reports

Longer-duration debt funds: Tactical bets are for risk takers

SANJAY KUMAR SINGH

Debt fund categories that maintain high portfolio duration have performed well over the past year. Long-duration debt funds have given a category average return of 7.7 per cent, Gilt funds (whose duration can vary widely) earned 7 per cent while gilt funds with 10-year constant duration fetched 6.6 per cent. Given these returns, investors may be tempted to invest in them. But they should first understand what they are getting into.

Good time to enter?

Experts say most major developed and emerging markets are at the end of their rate hike cycles. A couple of large central banks have or are on the verge of starting their rate-cut cycles. "Some uncertainty has been added in the past few weeks due to the uncertain global environment. So, we would advise investors to wait for a month or two before taking long-duration positions to avoid near term volatility," says Pranay Sinha, senior fund manager-fixed income, Nippon India Mutual Fund.

Chance to reap capital gains

Over the long term, one can expect higher returns from these funds, compared to a shorter-duration fund as they invest in longer maturity bonds, which usually offer higher coupon rates. At present, with interest rates at or near peak levels, yield to maturity (YTMs) of these funds are on the higher side, so investors will get entry at a good level.

Investors could also take tactical bets on them. "If and when a rate cut cycle takes place, investors could reap the benefit of capital gains from their long-duration bond fund holdings," says Sinha.

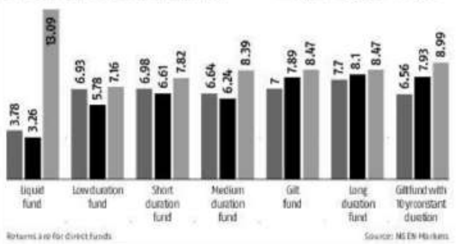
Adds Viplav Majumdar, founder, Planyourworld.com, "Retail investors should take expert help if they want to time their entry and exit."

Volatile categories

Investors who bet on these funds should be prepared for volatility. When rates rise, their net asset values (NAVs) tend to fall sharply.

HIGHER-DURATION FUNDS OUTPERFORM IN LONG TERM

CATEGORY AVERAGE TRAILING RETURNS (%)



Returns are for direct funds

Moreover, there is uncertainty regarding rate cuts. "Just because the Reserve Bank of India (RBI) has paused does not mean that rates will necessarily fall from here. If inflation increases, the central bank could be forced to undertake hikes. If the US Federal Reserve keeps hiking rates, the RBI may be forced to follow suit," says Deepesh Raghaw, a Securities and Exchange Board of India RIA (Registered Investment Advisor.

Interest rate cuts also appear to be some time away. In a recent poll conducted by Business Standard, seven of 10 participants said that they expect rate hikes to begin only from the first quarter of the 2024-25 financial year.

YOUR MONEY

Who should invest?

Those keen to take a tactical bet and having the necessary risk appetite may go for these funds. Buy-and-hold investors may also go for them provided they have a horizon of 7-10 years and don't mind the interim volatility. "With a longer horizon, even if there is an adverse rate movement the capital loss gets recovered through coupon payments. There will also be rate cut cycles over a long period," says Raghaw.

Who should avoid?

Majumdar says conservative investors who don't want high volatility in their debt fund portfolios should avoid these funds. Raghaw warns there could be times when their returns are negative over a year. He adds that investors who don't understand their inherent volatility should avoid these funds. Those with very short horizons should also steer clear.

Precautions to exercise

Long-duration funds can invest in both corporate bonds and gilts. If you invest in a fund from this category, go for one that doesn't take too much credit risk. "It is ideal to play long-duration strategies through sovereign or AAA bonds," says Sinha.

Before investing in a gilt fund, understand how much interest-rate risk the fund manager takes.

The 10-year constant maturity gilt fund category must invest 80 per cent of its portfolio in gilt and also maintain a Macaulay duration of 10 years. This means it will always be highly sensitive to rate changes.

Majumdar suggests that buy-and-hold investors consider investing in a target maturity fund with a long maturity that invests in gilts. Such a fund would offer near-certainty of return if held till maturity.

"With debt funds now taxed on a par with fixed deposits, compare a deposit's return with a debt fund's YTM to decide which is more attractive," says Raghaw.

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